

NFTs--State
Tax Issues

MTC Nexus Committee

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What is an NFT (nonfungible token)?

Wikipedia:

A **non-fungible token (NFT)** is a non-interchangeable unit of data stored on a blockchain, a form of digital ledger (collection of accounts in which transactions are recorded), that can be sold and traded.

It may provide license to use underlying digital asset, but not copyright. NFTs do not restrict sharing or copying of the underlying digital files.

NFTs are commonly digital art.

Artists can sell music as NFTs.

NFTs can represent game in-assets.

NFTs can function as tickets for an event.

What is
“nonfungible”?

A “nonfungible” item is unique, whereas a “fungible” item can be exchanged 1-for-1 for another fungible item, such as 1 bitcoin of cryptocurrency can be exchanged for another bitcoin. One NFT would not have the same value as another NFT.

Investopedia: Cryptocurrencies are fungible tokens, which are identical to each other and can serve as a medium for commercial transactions.

What is a blockchain?

Wikipedia:

A blockchain is growing digital list of records, called blocks, that are linked together using cryptography.

Ethereum was the first blockchain to support NFTs with its ERC-721 standard, first proposed in 2017, and is currently the most widely used. The ERC-721 standard can incorporate in the NFT a “smart contract” that will track ownership and provide for permissioned transfer of ownership with royalties to be paid to the creating artist.

How Can I Buy NFTs?

Investopedia:

Many NFTs can only be purchased with the Ethereum cryptocurrency Ether (ETH), which must be stored in a digital wallet in order to use. You can then purchase NFTs via any of the online NFT marketplaces, including OpenSea, Rarible, and SuperRare, to name a few.

NFT Sales History

Investopedia:

In early March 2021, a group of NFTs by digital artist Beeple sold for over \$69 million.

Twitter's Jack Dorsey tweeted a link to a tokenized version of the first tweet ever, in which he wrote: "just setting up my twtr." The NFT version of the first-ever tweet sold for more than \$2.9 million.

Wikipedia:

As of early 2021, most NFT artworks were selling for less than \$200, with a third selling for less than \$100.

Checkpoint: 3Q 2021 NFT sales volume reached >\$10 B

NFT for sale listed on OpenSea marketplace

The screenshot shows a web browser window displaying an NFT listing on the OpenSea marketplace. The browser's address bar shows the URL: `opensea.io/assets/0x3b3ee1931dc30c1957379fac9aba94d1c48a5405/576`. The OpenSea logo is in the top left, and a search bar is in the top center. The listing is for an NFT titled "Nyan Dogecoin" by the creator "Nyan Cat (Official)". The NFT image shows a pixelated orange cat riding a yellow and orange comet against a dark blue space background. The listing is owned by "Mondoir" and has 254 favorites. A "Make offer" button is visible. Below the image, there are sections for "Description" (text: "such wow. much fascinate. very currency."), "About Nyan Cat (Official)", and "Details". To the right, there is a "Price History" section with a dropdown menu set to "All Time" and a placeholder for a price chart with the text "No item activity yet". Below that are sections for "Listings" and "Offers". The Windows taskbar is visible at the bottom, showing the search bar, task view, and various application icons. The system tray shows the weather as "58°F Sunny" and the date/time as "2:47 PM 3/14/2022".

NFTs, explained: what they are, ... x Nyan Dogecoin - Nyan Cat (Offi... x +

opensea.io/assets/0x3b3ee1931dc30c1957379fac9aba94d1c48a5405/576

OpenSea

Search items, collections, and accounts

Explore Stats Resources Create

254 Nyan Cat (Official)

Nyan Dogecoin

Owned by Mondoir 254 favorites

Make offer

Price History

All Time

No item activity yet

Listings

Offers

Description

Created by NyanCat

such wow. much fascinate. very currency.

About Nyan Cat (Official)

Details

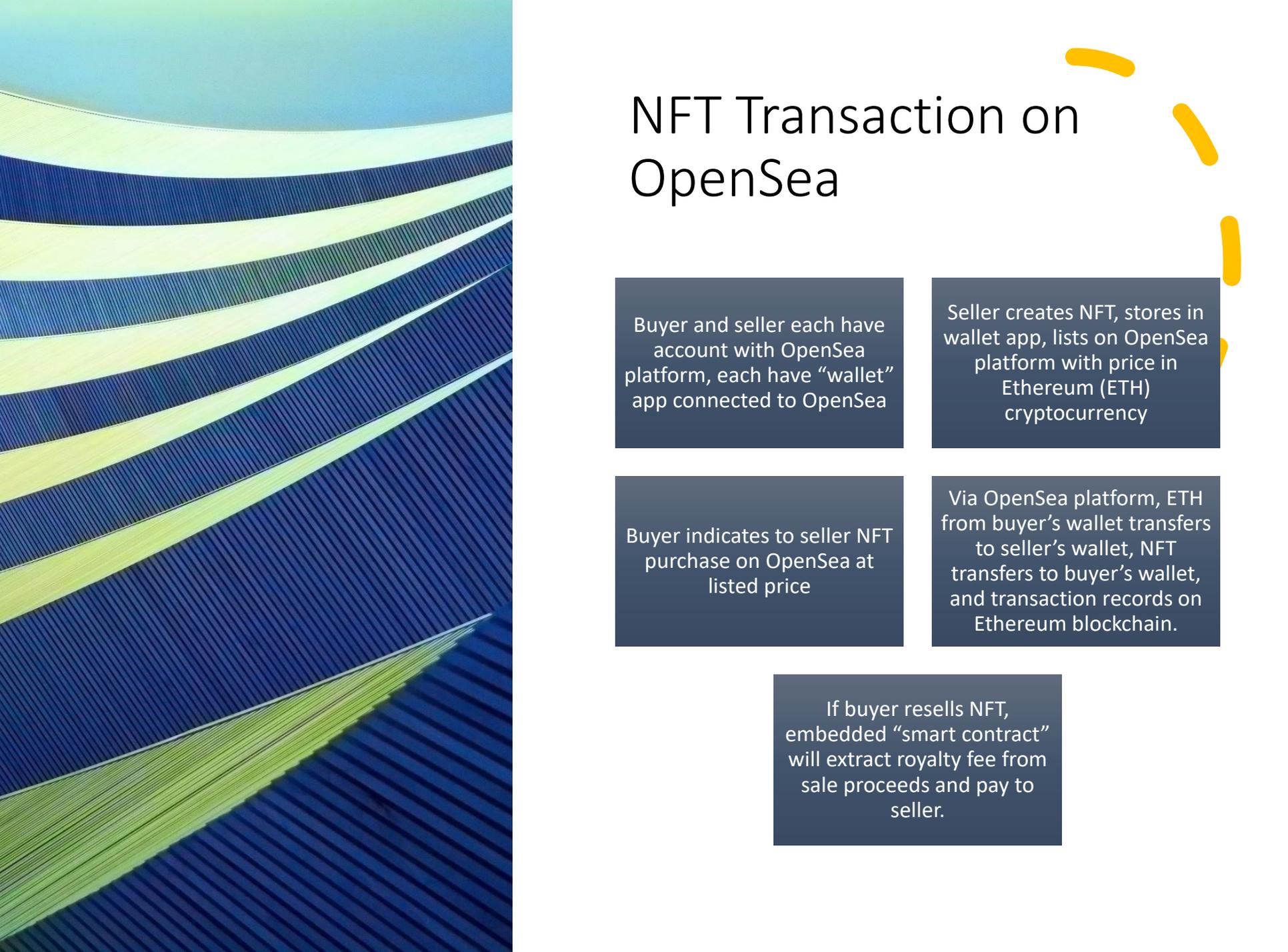
Type here to search

58°F Sunny 2:47 PM 3/14/2022



OpenSea sales statistics

- In last half of 2020, sales of artistic NFTs and user-generated content grew from \$1 million/month to \$20 million/month and the number of art NFT sellers increased from 1,395 to 8,770. As of January 2022, monthly NFT sales were \$5 Billion.



NFT Transaction on OpenSea

Buyer and seller each have account with OpenSea platform, each have “wallet” app connected to OpenSea

Seller creates NFT, stores in wallet app, lists on OpenSea platform with price in Ethereum (ETH) cryptocurrency

Buyer indicates to seller NFT purchase on OpenSea at listed price

Via OpenSea platform, ETH from buyer’s wallet transfers to seller’s wallet, NFT transfers to buyer’s wallet, and transaction records on Ethereum blockchain.

If buyer resells NFT, embedded “smart contract” will extract royalty fee from sale proceeds and pay to seller.

What is “gas”?

"GAS FEE" MEANS A FEE PAID TO THE OPERATOR OF A VIRTUAL NETWORK FOR THE USE OF THE NETWORK TO FACILITATE THE PURCHASE OR SALE OF VIRTUALCURRENCY OR AN NFT.

Arizona HB 2204

NFT income tax issues

Is the NFT seller selling it as inventory or as a capital asset?

Is the NFT buyer purchasing it as inventory or as a capital asset—and is it a “collectible?”

Did the NFT buyer have capital gain or loss on the value of the cryptocurrency used at the time of purchase of the NFT?

What is the buyer’s basis in the NFT?

IRS Cryptocurrency Income Tax Guidance

Notice 2014-21

Rev. Rul. 2019-24

IRS treats cryptocurrency as “property.”

NFT state tax guidance:

A few states have published cryptocurrency state income tax guidance, based on the IRS guidance, but so far no state has published NFT sales tax guidance.

Julian A. Fortuna, Eric Galen, and Gai Sher

How Should the Seller of an NFT Report It for Tax Purposes? Bloomberg Daily Tax Report March 4, 2022

- Buyer: if an NFT is purchased with cryptocurrency, then the purchaser must report a gain or loss on the disposition of the cryptocurrency.
- Seller (creator): Because NFTs are intangible assets, the difference between the costs of creating the NFT and the amount received by the creator should be taxed as ordinary income, plus applicable state income taxes. Sales tax withholding could also apply.
- If an NFT purchaser decides to resell the NFT, the original creator can automatically receive royalties that would be taxable when received.
- Dealers who buy and sell NFTs in the ordinary course of business should generally recognize ordinary income upon sale because the NFTs are considered inventory.
- NFTs held for investment rather than in a trade or business should qualify for capital gain or loss treatment upon sale.
- Gains from the sale of NFTs held for personal use would be taxable as capital gains, perhaps in some cases from the sale of a collectible.

James Rice, “Cryptoartists Also Need Creativity Figuring Out State Sales Tax,” Bloomberg Daily Tax Report August 31, 2021

NFTs tied to digital art may fit into one of many digital products or digital audiovisual works categories that are taxable.

Jeff Cook, Madeline Smith, Harley Duncan, “States Will Soon Be Looking to Collect on NFT Sales,” *Tax Analysts Tax Notes State*, March 21, 2022

The sale of an NFT that is linked to a video would appear to be a type of work that is taxable in several states.

OpenSea FAQ at opensea.io/tax-resources

Q: Can OpenSea do my taxes for me?

A: No. You are responsible for determining what, if any, taxes apply to your purchases, sales and transfers of NFTs.

Q: What do I owe in taxes?

A: Thankfully, there are third-party services who can help. We recommend CoinTracker as one such service.

Results for search of “sales tax” on OpenSea website

The screenshot shows a web browser window displaying an OpenSea listing for an "Alabama Sales Tax Token". The browser's address bar shows the URL: `opensea.io/assets/matic/0x2953399124f0cbb46d2cbacd8a89cf0599974963/76713340237281451600016247565674874569585160597424201446927239776754563284993`. The OpenSea logo is in the top left, and navigation links for "Explore", "Stats", "Resources", and "Create" are in the top right. A search bar is located below the navigation. The listing itself is for a "CoinForCollection" and features two images of a copper-colored token. The token's obverse (left) shows "DEPARTMENT OF REVENUE" and "1", while the reverse (right) shows "ALABAMA STATE SALES TAX TOKEN" and "1". The listing is owned by "Vikart0000" and has one favorite. The sale ends on August 23, 2022, at 8:33pm EDT. The current price is 0.02 ETH (equivalent to \$51.48). There are three buttons: "Buy now", "Buy with card", and "Make offer". Below the price is a "Price History" section with a dropdown set to "All Time" and a placeholder for a price history chart with the text "No item activity yet". At the bottom, there is a "Listings" section. The Windows taskbar at the very bottom shows the search bar, several application icons, and system tray information including "COMP +1.97%", "1:11 PM", and "3/15/2022".

Alabama Sales Tax Token - CoinF x +

opensea.io/assets/matic/0x2953399124f0cbb46d2cbacd8a89cf0599974963/76713340237281451600016247565674874569585160597424201446927239776754563284993

OpenSea

Search items, collections, and accounts

Explore Stats Resources Create

CoinForCollection

Alabama Sales Tax Token

Owned by Vikart0000 1 favorite

Sale ends August 23, 2022 at 8:33pm EDT

Current price

0.02 (\$51.48)

Buy now

Buy with card Make offer

Description

Created by Vikart0000
Alabama Sales Tax Token

About CoinForCollection

Details

Price History

All Time

No item activity yet

Listings

Type here to search

COMP +1.97%

1:11 PM
3/15/2022

NFT sales tax issues

- Is an NFT “software”?
- Is an NFT a “digital product” taxed by the state?
- Is an NFT “delivered,” “transferred” or “accessed”?
- How is the sale of an NFT sourced if neither seller or buyer know the location of the other?
- Do NFT marketplaces fit within the state’s definition of “marketplace facilitator/provider” (“narrow” vs. “broad” definition)?
- Has any NFT sales tax guidance been published?

Iowa “digital products” sales tax imposition

a. [Sales tax is imposed on retail sale of e]lectronically transferred digital audio-visual works, digital audio works, digital books, or other digital products.

b. For purposes of this subsection:

(1) "Digital audio-visual works" means a series of related images which, when shown in succession, impart an impression of motion, together with accompanying sounds, if any.

(2) "Digital audio works" means works that result from the fixation of a series of musical, spoken, or other sounds

(3) "Digital books" means works that are generally recognized in the ordinary and usual sense as books.

(4) "Electronically transferred" means obtained or accessed by the purchaser by means other than tangible storage media, including but not limited to a specified digital product purchased through a computer software application, commonly referred to as an in-app purchase, or through another specified digital product, or through any other means.

(5) "Other digital products" means greeting cards, images, video or electronic games or entertainment, news or information products, and computer software applications.